

Part I

Section 457.—Deferred Compensation Plans of State and Local Governments and Tax Exempt Organizations

26 CFR : 1.457-2

Rev. Rul. 2003-47

ISSUES:

- (1) Is the plan described below a length of service award plan described in § 457(e)(11)(A)(ii) of the Internal Revenue Code?
- (2) When are benefits under the plan includible in gross income?
- (3) Are benefits paid under the plan wages for purposes of FICA taxes?

FACTS

Pursuant to State S law, the County C Fire Department has adopted a written plan (the “Plan”) to implement County C’s volunteer fire fighters’ and rescue squad workers’ service award program. County C and its fire department intend the Plan to be a length of service award plan described in § 457(e)(11)(A)(ii). The County C Fire Department is an agency or instrumentality of County C which is an eligible employer within the meaning of § 457(e)(1) and maintains the plan. The County C Fire Department employs both professional and volunteer fire fighters.

The Plan has been established for the benefit of long-term bona fide volunteers who perform fire fighting, prevention, and rescue squad services for the fire department, including related essential services, such as services performed by dispatchers, mechanics, ambulance drivers and certified instructors. The Plan provides length of service awards to participating volunteers in recognition of their volunteer services to the fire department.

The Plan provides that benefits are only provided to a volunteer who does not receive compensation from the department for performing fire fighting and prevention services, emergency medical and ambulance services, and related essential services, other than reimbursement for (or reasonable allowance for) reasonable expenses incurred in the performance of such services, or reasonable benefits (including length of service awards) and nominal fees for such services, customarily paid by the department in connection with the performance of such services by volunteers.

Under the Plan, a bookkeeping account is established for each participating volunteer and, when a participating volunteer satisfies the Plan's age and service requirements for distribution of benefits, the volunteer automatically receives the balance of the volunteer's account, payable in 60 monthly installments beginning on the tenth day of the first month following the month in which the requirements are satisfied. If a participating volunteer dies prior to satisfying the Plan's age and service requirements, the balance of the volunteer's account is paid to the volunteer's beneficiary in a single sum within 60 days after the date of the volunteer's death. If a participating volunteer dies after payments under the Plan have commenced, but before receiving all monthly installments under the Plan, the balance of the volunteer's account is paid to the volunteer's beneficiary for the remainder of the 60 monthly installments.

Under the Plan, County C and its fire department each periodically provide credits to the accounts of participating volunteers. Each account is also credited with deemed earnings in accordance with the Plan and State S law. The deemed earnings are based on an index that does

not exceed a rate of return on a predetermined actual investment or a reasonable rate of return, as defined under § 31.3121(v)(2)-1(d)(2)(i) of the regulations. The Plan provides that the combined amount credited to any account with respect to any participating volunteer, other than deemed earnings, cannot exceed \$3,000 for any year of service credit.

The Plan provides that all amounts credited to the bookkeeping accounts, and all deemed earnings attributable to such amounts, remain solely the property of County C and its fire department, and, until paid or made available to a participant or beneficiary, are subject to the claims of County C's and the fire department's general creditors. The Plan also provides that a participating volunteer (or beneficiary) has only an unsecured right to an award under the Plan. The rights of a participating volunteer (or beneficiary) to an award under the Plan cannot be assigned and are nontransferable. If a participating volunteer ceases to provide services to the fire department prior to satisfying the Plan's age and service requirements for distribution of benefits (other than by reason of the volunteer's death or disability), the volunteer's rights to an award under the Plan are forfeited and County C and its fire department cease to have any liability regarding the volunteer's account.

LAW AND ANALYSIS

Section 451(a) and § 1.451-1(a) provide that generally an item of gross income is includible in gross income for the taxable year in which it is actually or constructively received by a cash basis taxpayer. Section 1.451-2(a) provides that income is constructively received in the taxable year during which it is credited to the taxpayer's account, set apart, or otherwise made available so that the taxpayer may draw on it at any time. However, income is not constructively received if the taxpayer's control of its receipt is subject to substantial limitations or restrictions.

Rev. Rul. 60-31, 1960-1 C.B. 174, holds that a mere promise by the service recipient to pay the service provider, not represented by notes or secured in any way, does not constitute

receipt of income within the meaning of the cash receipts and disbursements method of accounting. See also, Rev. Rul. 69-650, 1969-2 C.B. 106, and Rev. Rul. 69-649, 1969-2 C.B. 106.

Section 457 governs the taxation of deferred compensation plans of eligible employers. The term “eligible employer” is defined in § 457(e)(1) as a state, political subdivision of a state, and any agency or instrumentality of a state or political subdivision of a state, and any other organization (other than a governmental unit) exempt from tax under subtitle A of the Code. Deferred compensation plans maintained by eligible employers to which § 457 applies are either eligible plans or ineligible plans. An “eligible deferred compensation plan,” as defined in § 457(b), must, among other things, provide that the maximum amount which may be deferred under the plan for a taxable year will not exceed the lesser of the applicable dollar amount (\$12,000 in 2003) or 100 percent of the participant’s includible compensation. Section 457(a)(1) provides that compensation (and income attributable to such compensation) deferred under an eligible deferred compensation plan maintained by a political subdivision of a State is includible in a participant’s gross income in the taxable year in which the compensation (and income attributable to such compensation) is paid to the participant.

Section 457(f)(1)(A) provides that generally if a plan of an eligible employer providing for a deferral of compensation is not an eligible deferred compensation plan, compensation deferred under such plan is included in the participant’s gross income for the first taxable year in which there is no substantial risk of forfeiture of the rights to such compensation.

Section 457(e)(11)(A)(ii) provides that a plan paying solely length of service awards to bona fide volunteers or their beneficiaries on account of qualified services performed by such volunteers is treated as not providing for the deferral of compensation under § 457. Section 457(e)(11)(C) defines qualified services as fire fighting and prevention services, emergency medical services, and ambulance services.

Section 457(e)(11)(B) provides special rules applicable to a length of service award plan. Section 457(e)(11)(B)(i) defines a bona fide volunteer to include only persons whose only compensation received for performing qualified services are reimbursements for (or reasonable allowances for) reasonable expenses incurred in performing such services or reasonable benefits (including length of service awards) and nominal fees for such services, customarily paid by eligible employers in connection with the performance of such services by volunteers.

Section 457(e)(11)(B)(ii) provides that a length of service award plan may not provide for an aggregate amount of length of service awards exceeding \$3,000 accruing with respect to any year of service by any volunteer.

Section 3121(a)(5)(I) provides that any payment made to, or on behalf of, an employee or his or her beneficiary under a plan described in § 457(e)(11)(A)(ii) and maintained by an eligible employer, as defined in § 457(e)(1), is not treated as “wages” for purposes of Federal Insurance Contributions Act (FICA) taxes.

The Plan established by County C and its fire department satisfies the requirements of § 457(e)(11)(A)(ii). The Plan applies only to volunteers who provide qualified services, i.e., fire fighting and prevention services, emergency medical services, ambulance services, or other related essential services in compliance with § 457(e)(11)(C). The Plan also satisfies § 457(e)(11)(B)(i) by limiting eligible volunteers to persons who receive reimbursements, reasonable expenses, nominal fees, or reasonable benefits customarily paid by eligible employers in connection with the performance of qualified services by volunteers. Finally, the Plan satisfies § 457(e)(11)(B)(ii) by limiting the aggregate amount of awards for any year of service to \$3,000.

Since the Plan qualifies as a length of service award plan under § 457(e)(11)(A)(ii), neither § 457(a) nor § 457(f) apply to benefits under the Plan. Instead, amounts distributable under the Plan are includible in gross income under § 451 and the regulations thereunder, when paid or made available without substantial limitation or restriction.

In addition, since the Plan qualifies as a length of service award plan under § 457(e)(11)(A)(ii) maintained by an eligible employer (as defined in § 457(e)(1)), § 3121(a)(5)(I) provides that any payment made to, or on behalf of, a volunteer or his or her beneficiary under the Plan is not treated as “wages” for purposes of determining if FICA taxes apply to such payment.

HOLDINGS

- (1) County C’s Plan is a length of service award plan described in § 457(e)(11)(A)(ii). The Plan, therefore, is not subject to § 457(a) or § 457(f).
- (2) An award under the Plan is includible in a cash basis recipient’s gross income under § 451 and the regulations thereunder, in the taxable year when paid or made available without substantial limitation or restriction.
- (3) Awards paid under the Plan are not wages for purposes of FICA taxes.

DRAFTING INFORMATION

The principal author of this revenue ruling is John Tolleris of the Office of Division Counsel/Associate Chief Counsel (Tax Exempt and Government Entities). For further information regarding this revenue ruling contact John Tolleris on (202) 622-6060 (not a toll-free call).